Internal Revenue Service

memorandum

CC:TL:
Br3:SWIanacone

date: 10 JUN 1986

to: District Counsel, Houston SW:HOU
Attn: T. G. Norman

from: Director, Tax Litigation Division CC:TL

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subject: [redacted]

This is in response to your memorandum of April 3, 1986, requesting technical advice on the issue stated below.

Issue:

Whether I.R.C. § 162(g) is applicable to disallow a deduction of two-thirds of the settlement reached in the above-captioned case.

Summary:

We have concluded that for purposes of the settlement reached between the [redacted] and the taxpayers, I.R.C. § 162(g) would apply so as to disallow the deduction for two-thirds of the amount involved in the settlement agreement.

Facts:

On [redacted], the [redacted] filed a civil suit alleging that [redacted] and others ("taxpayers") participated in a bid rigging scheme to allocate among themselves [redacted] contracts and subcontracts in violation of Section 1 of The Sherman Act. The city was seeking damages under Section 4 of the Clayton Act (treble damages) and injunctive relief under Section 16 of The Clayton Act. The city alleged that the taxpayers colluded in the bid rigging scheme on [redacted] different contracts.

On [redacted] the [redacted] and the taxpayers entered into a settlement agreement whereby the taxpayers agreed to pay the city $[redacted]. As part of the settlement, the city agreed that the amount paid for the covenant not to sue was

not related to any antitrust or other criminal plea by the taxpayers. The $[redacted] settlement was deducted on the consolidated federal income tax return of the parent company ([redacted]) in its fiscal year ending [redacted].

As a result of various allegations, federal authorities in cooperation with state and local officials, conducted a widespread investigation of possible antitrust violations in the [redacted] industry in a number of states, including [redacted], [redacted], [redacted] and [redacted]. Pursuant to the federal investigation, the U.S. Attorney's office filed [redacted] indictments in the U.S. District Court in [redacted], alleging violations by the taxpayers of the Sherman Act. The U.S. Attorney's office in [redacted], also filed several indictments against the taxpayers alleging similar violations.

As part of what is known as a "global settlement", the taxpayers plead guilty to [redacted] of the [redacted] indictments brought in [redacted] and [redacted] of the indictments brought in [redacted]. All other indictments were dismissed as part of the settlement. Provisions contained in the global settlement estopped further criminal prosecution of the taxpayers due to any bid rigging of [redacted] contracts entered into at any time prior to the date of the global settlement. This settlement extended to all such bid rigging by the taxpayers anywhere in the United States and covered the period of time in which the [redacted] bid rigging occurred.

A companion civil case to the settlement, [redacted], was filed in the [redacted]. In the final judgment, the taxpayers were enjoined from any bid rigging in their [redacted] work. This final judgment was filed on [redacted], and is in effect for ten years from that date. The injunction is applicable to the entire United States and to all of taxpayers' [redacted] work.

The alleged violations cited in the [redacted] civil action, to which the taxpayers agreed to pay $[redacted], occurred prior to the guilty pleas by the taxpayers to the indictments contained in the global settlement and prior to the injunction obtained in the companion civil case.

Discussion:

Section 162(g), effective with respect to amounts paid or incurred after December 31, 1969, was added to the Code by § 902(a) of the Tax Reform Act of 1969, Pub. L. No. 91-172, 83 Stat. 710 (1969). Section 162(g) provides:

> If in a criminal proceeding a taxpayer is convicted of a violation of the antitrust laws laws, or his plea of guilty or nolo contendere to an indictment or information charging such a violation is entered or accepted in such proceeding, no deduction shall be allowed under [§ 162(a)] for two-thirds of any amount paid or incurred -
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> (1) on any judgment for damages entered against the taxpayer under Section 4 of the [Clayton] Act . . . on account of such violation or any related violation of the antitrust laws which occurred prior to the date of the final judgment of such conviction, or
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> (2) in settlement of any action brought under Section 4 on account of such violation or related violation.
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> The preceeding sentence shall not apply with respect to any conviction or plea before January 1, 1970, or to any conviction or plea on or after such date in a new trial following an appeal of a conviction before such date.

The discussion in your memorandum indicates that the activities which gave rise to the action brought by the [redacted] under Section 4 of the Clayton Act, occurred prior to the date of the final judgment of the taxpayers' guilty pleas. The issue, therefore, is whether the settlement was the result of an action brought under Section 4 on account of a "related violation" of the antitrust laws.

Neither Section 162(g) nor its legislative history defines a "related violation." Treas. Reg. § 1.162-22(c), however, provides the following definition of the term:

> (c) Related violation. For the purposes of [Section 162(g)], a violation of the Federal Antitrust Laws is related to a subsequent violation if (1) with respect to the subsequent violation the United States obtains both a judgment in a criminal proceeding and an injunction against the taxpayer, and (2) the taxpayer's actions which constituted the prior violation would have contravened such injunction if such injunction were applicable at the time of the prior violation.

Since the government obtained a judgment in the criminal proceeding along with a civil injunction and the activities of

the taxpayers occurred prior to the final judgment of their guilty pleas, if you determine that the taxpayers' activities would have contravened the injunction then they would be related violations.

Additionally, Treas. Reg. § 1.162-22(c) does not set forth absolute criteria that must be satisfied before a violation can be said to be a "related violation" for purposes of Section 162(g). Nor does the regulation set forth conditions precedent for the finding of a "related violation." Instead, the regulation is merely illustrative of the circumstances that demonstrate that a civil violation of the antitrust laws is related to a subsequent criminal violation.

Treas. Reg. § 1.162-22(c) was drafted in its present form in response to the Service being informed by the Department of Justice that its policy is to seek an injunction in a companion civil suit whenever it brings a criminal antitrust action. Based on this information, the Service apparently saw no further need to state in the § 162(g) regulations under what circumstances a civil antitrust violation would be "related" to a criminal violation.*/ In our view, a treble damages civil antitrust violation and a criminal antitrust violation accompanied by a civil injunction suit should be considered "related violations" for purposes of Section 162(g) if the civil violation was committed in order to accomplish the same ultimate economic objective as that for which the criminal violation was committed.

The economic objective test, in the context of substantial factual identity (other than dates) of both the criminal violation and the civil violation on which treble damage payments are based, is a reasonable and workable definition of the term "related violation." In fact, the three examples in Treas. Reg. § 1.162-22(f) support the economic objective-substantial factual identity test. In each example, the criminal violation to which the defendants entered a plea of nolo contendere is conspiring to fix and maintain prices in the electrical transformer market. In the first two examples the economic objective-substantial factual identity test is met because the violation for which treble damages are sought is also price fixing in the electrical transformer market. The price fixing violation for which treble damages are sought in example three, however, is with respect to the electrical insulator market, a factually dissimilar market, and thus, such a violation is not related to the criminal violation involving transformer price fixing.

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*/ Changes have been proposed in the Regulation in light of the Department of Justice's recent revelation that its policy, in fact, is not to seek a civil injunction whenever it brings a criminal action and the Tax Court's recent decision in Fisher Companies, Inc. v. Commissioner, 84 T.C. 1319 (1985).

In the instant case, the taxpayers' antitrust violations which formed the basis for the criminal indictments, to which the taxpayer entered pleas of guilty, are also the same as, or related to, the violations which formed the basis of the [redacted]'s civil action against the taxpayers under Section 4 of the Clayton Act. Although criminal indictments were brought in [redacted] and [redacted], but not in [redacted], this was due solely to the global settlement which precluded the government from naming the taxpayers as defendants in [redacted] or other areas. Regardless, it is clear that the violations which occurred in [redacted] and [redacted], for which indictments were filed against the taxpayers, had the same economic objective and substantial factual identity to the violations which occurred in [redacted]. Accordingly, any payments made by the taxpayers to [redacted] would be nondeductible under § 162(g)(2).

Based on an economic objective-substantial factual identity definition of the term "related violation" for purposes ofSection 162(g), we believe the criminal convictions obtained in [redacted] and [redacted] and the treble damage settlement payments made in this case would be for related violations. This is because of the ultimate economic objective and substantial factual identity of each antitrust violation (civil and criminal), the bid rigging scheme of the taxpayers to allocate amongst themselves [redacted] contracts and subcontracts.

Conclusion:

For both of the reasons discussed above, we conclude that for purposes of the settlement reached between the [redacted] and the taxpayers, I.R.C. § 162(g) would apply with the result that two-thirds of the deduction for the amount paid pursuant to the settlement agreement should be disallowed. If you have any further questions, please contact Steven W. Ianacone, (FTS) 566-3442.

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